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CITATIONS

618396—44——1

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. ——

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF ALEXANDER J. SHAMBERG, DECEASED, ISIDOR W. SHAMBERG, ADMINISTRATOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit, entered in the above case on September 29, 1944, affirming the decision of the Tax Court of the United States.

OPINIONS BELOW

The opinions in the Tax Court (I R. A. 2–36) are reported in 3 T. C. 131. The opinions in the Circuit Court of Appeals (II R. 1675–1705) are not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on September 29, 1944 (II R. 1706). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the bonds of the Port of New York Authority are those of a "state" or a "political subdivision" of a state within the meaning of Section 22 (b) (4) of the Revenue Acts of 1936 and 1938 and Article 22 (b) (4)–1 of Treasury Regulations 94 and 101, so that the interest received by the holders of the bonds is exempted from the federal income tax.

2. If the obligations are not those of a "state" or a "political subdivision" of a state within the meaning of the statute and regulations, whether there is any constitutional objection to the tax.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

The provisions of the Constitution and the statutes and regulations involved are set forth in the Appendix, *infra*.

STATEMENT

This case involves the income tax liability of Alexander J. Shamberg for the calendar years 1937 and 1938, and presents for determination the question whether interest received by him

during those years upon bonds of two certain issues of the Port of New York Authority is subject to tax. Shamberg having died while the case was pending in the Tax Court, his administrator was substituted for him.

The facts relating to the nature and activities of the Port of New York Authority (hereinafter called the Authority) were stipulated by the parties. They may be summarized as follows:

A. ORGANIZATION AND NATURE OF THE AUTHORITY

The Authority is a body politic and corporate, created by a compact entered into between the States of New York and New Jersey on April 30, 1921, and approved by Congress by joint resolution of August 23, 1921.[1] It is wholly owned by the two states and its projects are all operated in the interest of the public. No profits inure to the benefit of private persons. (I R. A. 36, 84) The compact was induced by the widely recognized necessity for joint state action in the development as a whole of the port of New York, which lies partly within the jurisdiction of each state. It created a district to be known as the "Port of New York District" (its boundaries being described in particularity), comprised of areas in both states and the waters between them; there are included within its limits approximately 200

[1] Laws of New York (1921), Vol. 1, c. 154, p. 492; Laws of New Jersey (1921), c. 151, p. 412; Joint Resolution of August 23, 1921, c. 77, 42 Stat. 174.

separate municipalities and a population of over 10,000,000. (I R. A. 37–38, 39.)

Article VI of the compact [2] vested the Authority with—

> * * * power and authority to purchase, construct, lease and/or operate any terminal or transportation facility within said district; and to make charges for the use thereof; and for any of such purposes to own, hold, lease and/or operate real or personal property, to borrow money and secure the same by bonds or by mortgages upon any property held or to be held by it * * *

except that property held by either state or by any of their municipalities should not be taken without the consent of the state or municipality affected. It was further provided that the powers granted by Article VI should not be exercised until the two states had approved a comprehensive plan for development of the port.

Article VIII provided that the jurisdiction of the public utilities commission of each state should extend "to railroads and to any transportation, terminal or other facility owned, operated, leased or constructed by the port authority, with the

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[2] All of the compacts, statutes, and resolutions relating to the Authority are compiled in two pamphlets which are part of the Record herein as Stipulation Exhibits D and E. An additional pamphlet containing the statutes relating to the Holland Tunnel is in the Record as Stipulation Exhibit J. I R. A. 43, 57.)

same force and effect as if such railroad, or transportation, terminal or other facility were owned, leased, operated or constructed by a private corporation."

The Authority was directed to make plans for the development of the district (Article XI), was empowered to make recommendations to the two states (Article XII), to intervene in proceedings affecting the commerce of the port and to petition bodies such as the Interstate Commerce Commission upon matters within the jurisdiction (Article XIII).

Article XVIII authorized the Authority, subject to the exercise of the power of Congress, to make rules and regulations relating to navigation and commerce, which rules, however, are to be effective only when concurred in or authorized by the legislatures of both states. The states agreed by Article XIX to provide penalties and means of enforcement of the orders, rules and regulations of the Authority. The Authority has made rules and regulations with respect to its bridges and tunnels which have been concurred in by the legislatures of the two states. Penalties for their violation were provided by state law, and the inferior criminal courts of the states were given jurisdiction to enforce these penalties. (I R. A. 86).

The powers of the Authority are vested in a board of 12 commissioners, six from each state. It has been the invariable practice of the com-

missioners to take an oath of office, and they may be removed only upon charges and after a hearing. Their actions are binding only after approval by a majority of the commissioners from each state, and the Governor of each state has a veto power over the acts of the commissioners from his state. (I R. A. 84–85.)

The comprehensive plan, adopted by the two states and consented to by Congress in 1922,[3] sets forth the principles upon which the development of the port should proceed, and provides that (Section 8):

> The port of New York authority is hereby authorized and directed to proceed with the development of the port of New York in accordance with said comprehensive plan as rapidly as may be economically practicable and is hereby vested with all necessary and appropriate powers not inconsistent with the constitution of the United States or of either state, to effectuate the same, except the power to levy taxes or assessments. * * * The port authority shall be regarded as the municipal corporate instrumentality of the two states for the purpose of developing the port and effectuating the pledge of the states in the said compact, but it shall have no power to pledge the credit of either

[3] Laws of New York (1922), c. 43; Laws of New Jersey (1922), c. 9; Joint Resolution of July 1, 1922, c. 277, 42 Stat. 822.

state or to impose any obligation upon either state or upon any municipality, except as and when such power is expressly granted by statute, or the consent by any such municipality is given.

The Authority has not up to this time applied for any grant of power to pledge the credit of either state, or to impose any obligation on either state, and has never applied to any municipality for the power to impose any obligation upon it. (I R. A. 45–46.)

The Authority is not subject to the debt limiting provisions of the constitutions of the two states; it was created in order to establish an agency with a borrowing power independent of state and municipal debt limitations. (I R. A. 37, 83–84.)

B. Operations

Vehicular Crossings. Pursuant to concurrent legislation by the two states the Authority has constructed, with the approval of the War Department, and owns and operates four bridges in the port area. These are the Goethals Bridge, the Outerbridge Crossing, the George Washington Bridge and the Bayonne Bridge. Consent for the construction of these bridges was granted by Congress in Acts of March 2, 1925, in accordance with the provisions of the Act of March 23, 1906, c. 1130, 34 Stat. 84, regulating the construction of bridges over navigable waters. Congress reserved

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the right to alter, amend or repeal each act (cc. 389-391, 43 Stat. 1094–1095). (I R. A. 48–55.) The Authority also operates the Holland and Lincoln Tunnels under the Hudson River. It constructed and owns the Lincoln Tunnel. The Holland Tunnel was constructed by the two states and operated by them through commissions until 1930, when it was turned over to the Authority; in 1931 the control, operation, tolls and other revenues of the tunnel were vested in the Authority, and it paid over to the two states the proceeds of a $50,000,000 issue of its own bonds. These bonds were known as "Interstate Bridge and Tunnel Bonds—Series E", and bonds of this issue are one of the two bond issues involved in this case. The other bond issue here involved was known as "General and Refunding Bonds—First Series" and was issued in connection with the financing of the Lincoln Tunnel. (I R. A. 58–65.)

Tolls are charged for the use by vehicles of the bridges and tunnels described above and the Authority advertises in order to increase traffic thereon. (I R. A. 66, 69.) Prior to the adoption of the comprehensive plan there were ferry companies operating between New York and New Jersey, and the Authority's bridges and tunnels are in competition with these ferries. As a result of this competition some of the ferries have either ceased operations or curtailed their services, while others have reduced their rates to meet the com-

petition. In 1933 the Authority successfully opposed an application by a private company to construct a competing bridge across the Hudson. (I R. A. 89–92.)

Inland Terminal Building. The Authority has constructed the first unit of a proposed system of inland terminals in the block bounded by 15th and 16th Streets, 8th and 9th Avenues in Manhattan. Its cost was $16,000,000 which was financed by the sale of that amount of "New York-New Jersey Terminal Bonds—Series D", and it began operation in October 1932. The building consists of a basement, sub-basement, street level floor and 15 upper floors. The second through the fourteenth floors of the building (1,880,000 square feet) and a small portion of the street level floor (20,000 square feet) are rented for manufacturing, loft, commercial and industrial uses. A small portion of the seventh, the majority portion of the fifteenth floor and all of the sixteenth floor are used as Authority administration offices. The basement and the majority portion of the ground floor of the building (a total of 266,000 square feet) are devoted to terminal purposes. Construction of such a building, that is, one used mostly for ordinary commercial purposes, was necessary in order to have a terminal at all, because a building at that location designed for terminal purposes only could not produce sufficient revenue to be economically

practical on a self-liquidating basis, the basis upon which the states had directed the Authority to construct it. The Authority has entered into agreements with eight trunk line railroads relating to the use of the Inland Terminal Building as a terminal station, at specified rates. The Authority operates the non-terminal portion of the building and maintains the terminal portions thereof, but the actual operation of the terminal facilities has been conducted by the lessee railroads themselves through a joint agent who is not an employee of the Authority. (I R. A. 66–70.)

Bus Service. Since 1931, and through the taxable years the Authority operated a bus service over the Goethals Bridge. (I R. A. 93.)

Use of Other Properties. In connection with the construction of the bridges and tunnels referred to, and the approaches thereto, the Authority has acquired various properties. Changes in plans have made the continued ownership by the Authority of some of these properties no longer necessary, and with respect to others it has not yet become necessary to utilize them for the purpose for which they were acquired. Pending such utilization or disposition of these properties the Authority has rented them to the public for the purpose of minimizing loss of capital investment. (I R. A. 71–72.)

Port Development. During the term of its existence the Authority has engaged in many

studies and surveys, has taken part in hearings, has sought federal legislation, has taken part in committees concerned with traffic in the district, has participated in actions before the Interstate Commerce Commission and has carried on similar activities in furtherance of the general work of port development and port protection, in order to improve transportation conditions, reduce living costs, and enable the Port of New York to meet the competition of other ports. (I R. A. 73–78.)

C. FINANCIAL SUMMARY

The Authority's facilities and activities have been financed principally by its bond issues. It has also received a (comparatively) small amount as appropriations and advances from the two states, and from federal grants, as shown in the following table (I R. A. 78):

State Appropriations	$2,856,693.11
Federal Grants	6,450,803.65
State Advances	18,650,000.00
Bond and Note Issues	205,551,582.82

The Authority's outstanding bonds (excluding those held by the Authority itself) on January 1, 1942, were in the amount of $178,781,000. (I R. A. 79).

The Authority's revenues are derived principally from the operation of its facilities and properties, and of these the main sources are the vehicular crossings. Additional revenues have come from interest on bank balances, and the state

appropriations and federal grants which it has received. (I R. A. 80.) Its net income from the operation of the four bridges, two tunnels and the Inland Terminal for each of the years from 1937 to 1941, after payment of operating expenses and interest upon funded debt, was as follows (summarized from Paragraph 103 of the stipulation, I R. A. 81–82):

Year	*Amount*
1937	$5,437,485.79
1938	4,170,698.60
1939	5,224,111.46
1940	6,306,399.76
1941	8,512,581.66

The two states have adopted legislation regulating the use by the Authority of its revenues and they have been used as so directed. They have been expended solely for the operating and administrative expenses of the Authority and for interest upon and retirement of outstanding debt. (I R. A. 82.) The revenues for the year 1941 were expended as follows (I R. A. 83):

Interest on debt		28.58%
Sinking and Reserve Funds for Retirement of Debt		46.78%
Operation and Maintenance:		24.64%
Policing	4.19%	
Port Development & Protection	.47%	
Lighting and Ventilation	2.68%	
Administration and Law	2.39%	
Insurance and Pensions	6.06%	
Cleaning	.78%	
Heating	.42%	
Toll Collections	1.85%	
Other Operating Expenses	5.80%	
	24.64%	
		100.00%

The distribution of revenues for 1941 was typical of that for prior years, with minor variations for the items of operation and maintenance; the percentage of revenue expended on interest has been decreasing and the percentage devoted to the retirement of debt has been increasing as the funded debt gets closer to maturity. (I R. A. 83.)

In the compact pursuant to which the Authority was created the states agreed to make annual appropriations (not in excess of $100,000 for each state) for expenses of the Authority until revenues from its own operations were sufficient. These annual appropriations were discontinued in 1934, at which time the Authority's revenues from its bridges, the Holland Tunnel and Inland Terminal No. 1 became sufficient to meet its expenses. (I R. A. 85.)

D. IN GENERAL

In the operation of its bridges and tunnels the Authority maintains a uniformed police force, the members of which are designated by statute as regular police and peace officers of both states. (I R. A. 65.) The property of the Authority and the bonds and other securities issued by it are exempt from state taxation in both states. In both states its bonds are legal trust investments and financial institutions are authorized to give security to the Authority for deposits made by it. It has the power of condemnation, its employees

may join the New York State retirement system and the Authority has been held to be immune from suit. No tax or assessment is levied within the Port District by or on behalf of the authority. (I R. A. 85, 88.)

Had he been alive at the time of the hearing, Shamberg would have testified that he acquired the bonds of the Authority here involved in reliance upon legal advice that the income therefrom was immune from federal income taxation under the Constitution and that it was further expressly exempt from such tax under the existing statutes and regulations. (I R. A. 88–89.)

The Commissioner determined deficiencies of $1,580 and $913.62 for the years 1937 and 1938, respectively, based upon the inclusion in gross income of the interest received upon the Authority bonds. (I R. A. 2.) The Tax Court held the interest to be exempt from tax under Section 22 (b) (4) of the Revenue Acts of 1936 and 1938, and reversed the Commissioner's determination. Five judges dissented, and one did not participate. (I R. A. 2–36.) The Circuit Court of Appeals, one judge dissenting, affirmed the Tax Court's decision upon the same ground (II R. 1675–1705.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In construing the term "political subdivision" in Section 22 (b) (4) of the Revenue Acts

of 1936 and 1938 to mean state instrumentalities generally.

2. In construing the requirement of Article 22 (b) (4)–1 of Treasury Regulations 94 and 101 that a "political subdivision" must possess "the right to exercise part of the sovereign power of the State" and in holding that the Authority is a political subdivision of a state within the meaning of the regulations.

3. In construing the term "issued on behalf of a state" in Article 22 (b) (4)–1 of Treasury Regulations 94 and 101 and in holding that the Authority's bonds were issued on behalf of a state within the meaning of the regulations.

4. In holding that Congress intended an organization created pursuant to an interstate compact to be classed as a "political subdivision" of a state within the meaning of Section 22 (b) (4).

5. In holding that interest on bonds of the Port of New York Authority is exempt from tax under Section 22 (a) and (b) (4) of the Revenue Acts of 1936 and 1938.

6. In failing to hold that interest on bonds of the Port of New York Authority is subject to tax under Section 22 (a) and (b) (4) of the Revenue Acts of 1936 and 1938, and in failing further to hold that there is no constitutional objection to the tax.

7. In affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT

1. This case presents first for consideration the meaning and scope of Section 22 (b) (4) of the Revenue Acts of 1936 and 1938 (Appendix, *infra*), which exempts from income tax interest on "the obligations of a State, Territory, or any political subdivision thereof, * * *." If, as we contend, the statutory exemption does not extend to obligations of such an instrumentality as the Authority, then the case presents the further question whether there is any constitutional objection to the tax.

These questions are of great public importance not only to the Government and to the Authority but to the large and growing number of other state instrumentalities of a similar nature. We have listed in footnote 9, *infra*, p. 23, a number of such agencies which have been created by interstate compacts to which Congress has consented. In addition a very large number have been created by the several states acting individually. In New York alone there are 39 authorities or commissions (the earliest of which was created in 1929 and 13 of which have been created since 1940) with power to operate specific projects and to issue bonds which are not debts of the state and are payable solely out of the receipts from the operations of the particular authority or com-

mission.[4] It is important administratively that an authoritative guide be furnished for the determination of the tax status of the interest on such obligations. Such a guide is also important from the standpoint of the agencies, especially those which have financing programs in contemplation, for much uncertainty now attends such financing.[5]

The Government believes that its position is sound and that the questions involved should be settled so that protracted litigation throughout the various circuits may be avoided. In addition, if we are correct in our position but must await a later case, the Government will have lost substantial revenues in the interim.

2. The holding by the majority below that the obligations of the Authority are those of a "state" or a "political subdivision" within the meaning of Section 22 (b) (4) is in substantial conflict with *Helvering* v. *Gerhardt,* 304 U. S. 405, which upheld the imposition of an income tax upon the salaries of employees of the Authority. Although

[4] There are eight park, parkway, and highway authorities; five bridge and tunnel authorities; three market authorities; two public utilities authorities; sixteen housing authorities; and five miscellaneous authorities. See McKinney's Cons. Laws of New York, Book 42, Articles 2–7. As Judge Frank has pointed out in his dissenting opinion (II R. 1701), among the miscellaneous authorities are one to operate a planetarium (Article 7, Title 2) and one to operate an industrial exhibit (Article 7, Title 3).

[5] See the materials referred to by Judge Frank. (II R. 1688–1689.)

the *Gerhardt* case did not directly involve Section 22 (b) (4), it did necessitate consideration of similar language in a Treasury Regulation. The opinion first dealt with, and rejected, a contention that the employees enjoyed constitutional immunity from the tax, and then considered the effect of Article 643 of Treasury Regulations 77, which as originally promulgated provided:

> Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable.

The Court said (p. 423):

> If the regulation be deemed to embrace the employees of a state-owned corporation such as the Port Authority, it was unauthorized by the statute. But *we think it plain that employees of the Port Authority are not employees of the state or a political subdivision of it within the meaning of the regulation as originally promulgated*—an additional reason why the regulation, even before the 1938 amendment, was ineffectual to exempt the salaries here involved. [Italics added.]

It will be observed that the regulation laid down two requirements for the tax exemption: (1) The compensation had to be paid by a state

or political subdivision, and (2) it had to be paid to one who rendered services in connection with an essential governmental function. In holding that the regulation was inapplicable the Court might have relied upon the absence of either of these factors. Contrary to the interpretation of the opinion by the majority below (II R. 1682), the Court did not rely upon the absence of the second factor; it chose as its reason for holding the regulation inapplicable the ground that the Authority is not a state or a political subdivision of a state. It is true that the Court added "within the meaning of the regulation", but there is no basis for attributing to the term "political subdivision" as used in the regulation any different meaning from that to be attributed to it as used in Section 22 (b) (4).

3. Independently of the ruling in the *Gerhardt* case, the conclusion should have been reached, we believe, that the obligations of the Authority are not those of a "state" or a "political subdivision" of a state within the meaning of the exempting provision. We merely indicate here, without elaboration, the reasons for this view, to show the substantial character of the questions decided by the court below.

The suggestion by the circuit court of appeals that the Authority's obligations are those of a state or are issued on behalf of a state is at war with the facts. Indeed, it is precisely because the

Authority's obligations are not contracted "by or on behalf of" either of the two states that the state constitutional limitations on the contracting of such debts have been successfully avoided.

Nor are the Authority's obligations those of a "political subdivision" of a state. The majority opinion below does not suggest that the Authority is a "political subdivision" within the usual or ordinary meaning of the term, but holds that Section 22 (b) (4) should be read broadly as applying to state instrumentalities in general. But "instrumentality" is a word of broader scope than the phrase "political subdivision" found in the statute. The approach to the question taken in the opinion below not only violates the canon that exempting provisions of the tax statutes must be strictly construed, but is inconsistent with the purpose of Congress in enacting the section and also conflicts with the Treasury Regulations. Nor is it supported by the opinions of the Attorney General,[6] relied on in the majority opinion. Those opinions, as well as the Regulations, define a "political subdivision" in terms of the powers of sovereignty which may be exercised, and no such powers have been delegated to the Authority. The Authority was not given supervisory powers over other than its own facilities, and was itself made subject to supervision by State regulatory bodies.

[6] 30 Op. A. G. 252; 38 Op. A. G. 563.

The legislative history shows that the exempting provision, which first appeared in the Income Tax Act of 1913, c. 16, 38 Stat. 114, 166, was dictated by constitutional doubts concerning the power of Congress to tax the income from state and municipal bond issues. (50 Cong. Record, Part 1, p. 508.) *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601, had held that Congress was without power to tax the interest on bonds of the City of New York. However, it was clear at that time from *South Carolina* v. *United States*, 199 U. S. 437 (1905), that any implied immunity of the states from the impact of the federal taxing power extended only to those activities of a strictly governmental character essential to the continued existence of the states, and did not extend to activities of a proprietary nature. *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, had already been decided (1911), in which the Court had said (p. 172), "It is no part of the essential governmental functions of a State to provide means of transportation, * * *" and had referred to (p. 158) "the establishment of a judiciary, the employment of officers to administer and execute the laws and similar governmental functions * * *" as indicating the nature of state activities which enjoyed immunity from the effects of the federal taxing power. Thus at the time of the enactment of the Income Tax Act of 1913 there was no constitutional doubt concerning the power of Con-

gress to tax a proprietary instrumentality of a state directly, and, *a fortiori*, to tax a private person on interest received from bonds issued by such an instrumentality. Insofar as the decision below holds that the Authority is not a proprietary instrumentality, it is, in our view, in conflict with *South Carolina* v. *United States*, *supra*, and the cases which have followed it.

4. Even upon the assumption that Section 22 (b) (4) applies to state instrumentalities in general, there remain in the instant case important questions growing out of the fact that the Authority was created by an interstate compact which required the consent of Congress before it could become effective. And the resolutions granting consent to the compact and the comprehensive plan contain provisos expressly reserving to Congress "the right to alter, amend or repeal".

Neither New York nor New Jersey can, acting unilaterally, withdraw from the compact.[7] Furthermore, the compact does not provide, as have others,[8] that it may be dissolved by mutual consent of the two states. We think that therefore the two states could not, without the consent of Congress, jointly abolish the Authority for such attempted action would amount to a new compact

[7] *Green* v. *Biddle*, 8 Wheat. 1, 91–93; *Rhode Island* v. *Massachusetts*, 12 Pet. 657, 725; *Virginia* v. *West Virginia*, 11 Wall. 39; *Poole* v. *Fleeger*, 11 Pet. 185, 209–211.

[8] E. g., see the compact involved in *Hinderlider* v. *La Plata Co.*, 304 U. S. 92, 109.

which would in turn require Congressional consent. But Congress, by the simple act of repealing the resolution granting consent to the compact, may, with one stroke, abolish the Authority. In these circumstances it is wholly inaccurate to treat the Authority as an instrumentality of the states alone.

This aspect of the case is not peculiar to the Port of New York Authority, but has a general importance, for recent compacts approved by Congress have authorized the creation of at least six commissions or authorities with functions more or less similar to those of the Port of New York Authority.[8]

5. In our view all of the reasons which show that the statutory exemption does not apply to the obligations of such an instrumentality as the Authority make clear also that there is no constitutional objection to the tax, and that there

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[8] Lake Champlain Bridge Commission, Joint Resolution of February 16, 1928, c. 87, 45 Stat. 120, amended by Joint Resolution of August 23, 1935, c. 625, 49 Stat. 736, and Joint Resolution of June 4, 1936, c. 504, 49 Stat. 1472; Niagara Frontier Bridge Commission, Act of June 17, 1930, c. 499, 46 Stat. 764; Buffalo and Port Erie Public Bridge Authority, Joint Resolution of May 3, 1934, c. 196, 48 Stat. 662; Delaware River Joint Toll Bridge Commission, Act of August 30, 1935, c. 833, 49 Stat. 1058; Palisades Interstate Park Commission, Joint Resolution of August 19, 1937, c. 706, 50 Stat. 719; The Maine-New Hampshire Interstate Brige Authority, Act of July 28, 1937, c. 530, 50 Stat. 538.

could have been none even when the immunity doctrine was at its height. *South Carolina* v. *United States, supra.* In any event recent decisions have held that no private person enjoys any immunity from the federal income tax simply because his income happens to be derived from dealings with a state or a state instrumentality. *Helvering* v. *Gerhardt,* 304 U. S. 405; *Graves* v. *N. Y. el rel. O'Keefe,* 306 U. S. 466; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514; *James* v. *Dravo Contracting Co.,* 302 U. S. 134; *Alabama* v. *King & Boozer,* 314 U. S. 1; *Helvering* v. *Mountain Producers Corp.,* 303 U. S. 376. We think that no valid distinction can be drawn between these cases and the case of a private person who receives interest on bonds of a state or a state instrumentality. The interest is simply compensation for the use of borrowed money and such compensation stands in no different constitutional light from compensation paid for any other kind of service, or for goods. It is our position that recent decisions preclude any implication to the contrary which might be drawn from *Pollock* v. *Farmers' Loan & Trust Co.,* 157 U. S. 429, 158 U. S. 601, and that in any event the Sixteenth Amendment empowers Congress to tax "incomes, from whatever source derived," which includes interest on bonds issued by a state or a state instrumentality. See Mr. Justice Black's concurring opinion in the *Gerhardt* case, *supra.*

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

CHARLES FAHY,
Solicitor General.

NOVEMBER, 1944.

APPENDIX

Constitution of the United States:

> Art. 1, Sec. 10, Clause 3—No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.
>
> Sixteenth Amendment—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(4) *Tax-Free Interest.*—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia;

The provisions of Section 22 (a) and (b) (4) of the Revenue Act of 1938, c. 289, 52 Stat. 447, are the same as the above-quoted section.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

Art. 22 (b) (4)-1. *Interest upon State obligations.*—Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from the income tax. Obligations issued by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State or Territory or a political subdivision thereof. Special tax bills issued for special benefits to property, if such tax bills are legally collectible only from owners of the property benefited, are not the obligations of a State, Territory, or political subdivision. The term "political subdivision," within the meaning of the exemption, denotes any division of the State or Territory which is a municipal corporation, or to which has been delegated the right to exercise part of the sovereign power of the State or Territory. As thus defined, a political subdivision of a State or Territory may, for the purpose of

exemption, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State or Territory.

The provisions of Article 22 (b) (4)–1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, are the same as the above-quoted article, except that the words "or may not" follow the word "may" in the last sentence.

U. S. GOVERNMENT PRINTING OFFICE: 1944

(17)

IN THE

Supreme Court of the United States

October Term, 1944.

No. 707.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF ALEXANDER J. SHAMBERG, Deceased,
ISIDOR W. SHAMBERG, Administrator.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

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CITATIONS.

IN THE

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I. Preliminary Statement.

In determining whether or not to grant the writ as prayed for the Court will have it in mind that Congress has clearly, definitely and repeatedly manifested its intention to exempt the obligations of States from taxation. Since the organization of "Authorities" is purely a measure of economic and financial convenience, the only effect of a tax on their obligations would be either to compel the States to do directly what they now find it convenient to do through these agencies or else to curtail programs of public improvements and other activities of the sort that produce employment.

If it be urged that the result would be wholesome if "Authority borrowing" were curbed, we respectfully suggest that this question of public policy is primarily legislative and constitutes no sound reason for granting the writ in this case.

The Commissioner in effect asks the Court to discriminate among various classes of State agencies.

It is further suggested that of all times the present would be a most unfortunate time to hamper States and municipalities in planning to relieve the cyclical depression that inevitably follows a war.

II. Statement of Facts.

A Supplemental Statement of Facts is set forth in the Appendix.

III. Reply to Reasons Given for Granting the Writ.

While the Commissioner specifies seven errors which he proposes to urge, the reasons actually given for granting the writ are four in number. No one of them raises a constitutional issue.

1. The first is the administrative importance of "an authoritative guide" for the determination of the tax status of interest on agency obligations.

This reason presupposes a present administrative uncertainty which does not in fact exist. For almost thirty years under every income tax act down to the time when the Commissioner himself departed from the settled practice of his Bureau and assessed the tax in question there had been an unbroken series of treasury rulings, treasury regulations and treasury practice, as well as the opinions of two Attorneys General. These rulings and opinions (Exhibits 2 and BB) cumulatively constituted an "authoritative guide" of a definite and satisfactory sort. When the Commissioner by his revolutionary ruling undertook to weaken the authority of this guide he was quickly checked by the Tax Court and by the Circuit Court of Appeals. The status quo ante has now been restored. There is, we submit, no occasion for action by this Court. Were there any cogency in the reason now

under consideration it certainly would have appealed to the Tax Court which is ideally fitted to deal with the sort of question which the instant case presents. From recent decisions of this Court [1] it is evident that findings of the Tax Court are to be accorded great significance and weight. Unless some measure of finality is imputed to the judgments of the Tax Court in cases like this, there is no way in which the Supreme Court can protect itself against a flood of tax appeals.

The simple fact is that billions of dollars of bonds have been issued, sold and resold on the basis of the universal understanding that the income from such bonds is by statute exempt from federal taxation. During all the years not a dollar of tax was exacted by an Internal Revenue Collector until, to start a "test case", a half dozen bondholders were selected as subjects for experiment. The release cited in the footnote [2] shows that the Treasury hoped to induce this Court to reconsider its previously expressed views and further hoped that, having secured such a reconsideration, the way would be open for an appeal to Congress to repeal the statutory exemption. This is nothing more nor less than an attempt to get this Court to exert a kind of collateral pressure upon Congress after direct pressure during a period of over thirty years had wholly failed. It is significant to note that since 1913 many bills have been introduced into Congress in a vain attempt to repeal the exemption or to launch a constitutional amendment.[3] It is a fair inference from this record that if an

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[1] *Dobson v. Commissioner*, 320 U. S. 489 (1943); *Security Mills Co. v. Commissioner*, 321 U. S. 281 (1944); *McDonald v. Commissioner*, 13 Law Week 4013 (Nov. 21, 1944); *Commissioner v. Scottish American Investment Co.*, 13 Law Week 4033 (Dec. 5, 1944).

[2] The statement of the Treasury issued at the time this action was commenced is set forth in full in the Appendix.

[3] Bills introduced in the House numbered 8 and in the Senate 2. Resolutions proposing constitutional amendment numbered 79 in the House and 18 in the Senate.

act to limit the exemption by excluding "Authorities" would have had the least chance of success, legislation to effect the limitation would have been proposed long ago. On the contrary, as appears from the treasury release already cited, everybody, including the Commissioner, assumed that the real question intended to be presented in this case is the exemption of the obligations of States and that as long as this is preserved, the exemption of the agent would follow as a matter of course. What was started as a test case has now degenerated into a mere controversy as to whether the obligations of State Authorities are or are not within the statutory exemption. This is a mixed question of statutory interpretation and administrative practice which has been dealt with effectively by the Tax Court and by the Circuit Court of Appeals.

It is the Treasury's announced intention to seek to undo the decision of this Court, if it is in favor of the Petitioner, by obtaining legislation abating back taxes on Authority bonds. (Exhibit 1.) The Court has already refused to be a party to a similar arrangement in *Helvering v. Griffiths,* 318 U. S. 371 (1943), observing that "This assurance that if we will but find that Congress has intended to lay the tax it will be asked to declare that it does not intend it to be collected is hardly reassuring that the decision contended for would be what Congress intended."

2. The second reason is an alleged conflict between the decision of the Circuit Court of Appeals and the decision of this Court in *Helvering v. Gerhardt,* 304 U. S. 405 (1938). We submit that upon analysis it will be found that there is no such conflict as is asserted by the Commissioner.

In the *Gerhardt* case the question was whether an employee of the Authority might successfully claim exemption from income tax. There was no specific statutory exemption to which he could appeal but merely a treasury regulation which construed the revenue act as exempting by implication the compensation of employees of a State or

of a political subdivision thereof for "services rendered in connection with the exercise of an essential governmental function of the State." Neither the Circuit Court of Appeals nor this Court disturbed the careful and exhaustive fact-findings of the Board of Tax Appeals respecting the nature and scope of the Authority's activities. Apparently accepting the facts as found, this Court held that the tax in question was non-discriminatory and that the employment of the petitioner was not shown to be different from that of similar employees of private industry. The Court therefore concludes that employees of the Port Authority are not employees of the State or a political subdivision of it "within the meaning of the regulation." The majority of the judges of the Tax Court and the Circuit Court of Appeals in this case thought (and, we submit, correctly) that this was not an adjudication of the legal status of the Authority but merely a decision that the services of the employee were not such as to come within the scope of the Treasury Regulation. This view is supported by the fact that in the *Gerhardt* case this Court was careful to express "no opinion whether a federal tax may be imposed upon the Port Authority itself with respect to its receipt of income or its other activities, we decide only that the present tax neither precludes nor threatens unreasonably to obstruct any function essential to the continued existence of the state government." This reservation would have been manifestly superfluous if the Court had intended to deny to the Authority, under any and all circumstances, the status of a State or of a political subdivision thereof.

3. The third reason given is that the obligations of the Authority are not those of a State or of a political subdivision and were not issued on behalf of a State. This, we respectfully submit, is the mere assertion of a conclusion. The decision of the Circuit Court of Appeals that the Authority's obligations are those of a State or are issued on behalf of a State is not (as suggested by the Commissioner) "at war with the facts" but is in strict

conformity with all the facts as found. This becomes clear upon a mere perusal of the Stipulation of Facts (1 R. A. 36-89) and of the majority opinions in the Tax Court and the Circuit Court of Appeals. In this connection we submit the following three suggestions:

(a) That the Tax Court is ideally fitted to determine such a question of fact as what constitutes sound administrative precedent and what, on the point in issue, the intention of Congress actually is. The controlling importance of the decisions of the Tax Court in cases of this sort has been emphasized by this Court in *Dobson v. Commissioner,* supra. We submit that on this record there is no sound reason for reviewing this determination.

(b) That beyond all question, the respondent-Authority is a body politic and corporate and that to it have been subdivided some of the functions of the constituent States. The question is not whether the Authority *is* the State or wields all of its powers but whether it is discharging on behalf of the State a limited function which the State itself might discharge directly.

(c) That the interpretation placed by the Circuit Court of Appeals upon the term "political subdivision" is in precise accordance with the contention that the Department of Justice recently made in *Platte Valley Public Power & Irrigation District v. County of Lincoln,* Nebraska Supreme Court Journal April 18, 1944, p. 235. In this case the Government of the United States, being the owner of the obligations of the Power & Irrigation District, contended that the property of the District was exempt from State taxation under a provision of the Nebraska Constitution which exempted the property of "governmental subdivisions" from taxation. Of a contrary decision by the lower court the brief of the United States had this to say:

"The lower court held that the phrase 'governmental subdivision' as used in Section 2 of Article VIII of the Constitution had to be construed 'so as to include only subdivisions of the state that have as their primary purpose the performance of governmental functions, as distinguished from proprietary functions.' The distinction between 'governmental' and 'proprietary' powers was made originally with respect to municipal corporations in order to form a basis for implied civil liability for damages caused by the negligent execution of powers of the character commonly exercised by private individuals as well as by public corporations. This distinction still exists primarily as a basis for determining tort liabilities of public bodies. 1 Dillon, Corporations, Sec. 39. It has also been employed in sustaining federal taxation of the business activities of states. See South Carolina v. United States, 199 U. S. 437. It seems very unlikely that either the framers of the constitution or the public which approved it had this highly technical distinction in mind when they established by their constitution a tax exemption for the property of the state and its governmental subdivisions."

The Supreme Court of Nebraska decided in accordance with the contention of the United States and reversed the judgment appealed from.

4. The fourth and final reason given is that even if the statutory exemption applies to State instrumentalities in general, it is inapplicable to the respondent because created by interstate compact requiring the consent of Congress.

We respectfully suggest that this contention is a mere make-weight.

If the policy behind the exemption clause is considered it is hard to think of any reason why Congress should have wished to exempt an agency of one State and to tax an

agency of two. It is not a situation in which there is any fundamental difference between joint and several State activities. If New York and New Jersey had simultaneously created two corporate agencies and directed them to cooperate, each would have been (by supposition) a political subdivision of the constituent State and the bonds issued by each would have been exempt. We submit that the exemption in such a case would have been due to the desire of Congress to respect the initiative of the States as independent sovereignties each discharging its proper governmental functions and that this congressional policy is a matter of substance, not of form, and is as applicable where the action is joint as it would be if the States acted severally. Had the exemption clause read thus: "the obligations of States, Territories and the political subdivisions thereof", the plural form of words would have drawn the sting from the petitioner's argument based on the singular form—but the meaning would not really have been different. The common sense interpretation of the actual language is that the exemption is applicable to a political subdivision of States as well as to a political subdivision of *a* State.

For these reasons the respondent contends that the Authority is, as respects the exemption clause, as much within the exemption accorded by Congress to political subdivisions as is the Triborough Bridge Authority which is the agency of a single State.

In the course of the argument in support of the petition for the writ, the Commissioner urges that the Authority is to be classified now as if it were a "public utility corporation." After nearly twenty-five years of recognition as a governmental agency this contention does violence to the nature of the Authority as determined by the court below and as required by the facts included in the

"stipulation of facts." We do not think this Court will require argument to brand the contention as altogether unrealistic.

We respectfully submit that the Commissioner's petition for certiorari should be denied.

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APPENDIX.

Supplemental Statement of Facts.

The petitioner has included within his petition a Statement, which while setting out many of the powers and authorities of the Port of New York Authority, also omits some which the respondent believes are pertinent to the questions now presented to this Court, and it, therefore, submits the following facts with regard to the Authority, all of which were stipulated in the proceedings before the Tax Court.

The Port Compact was evolved after a series of individual efforts by the States of New York and New Jersey and was preceded by full legislative investigations and reports. (Stip. 10.)[1] These called for the creation of a port authority to solve a port problem which was characterized as a great sociological problem of chief concern to the public at large, throwing a heavy burden on the commerce of the port, adding to the cost of living, and curtailing the port's utility in time of war. (Stip. 20.) The Authority's vehicular crossings have been recognized by statute to be "for the benefit of the people of the States of New York and New Jersey, for the increase of their commerce and property and for the improvement of their health and living conditions; and the Port Authority shall be regarded as performing an essential governmental function * * *." (Stip. 3.) It is the joint agency of the two States (Stip. 1) having no stock and no stockholders, but being wholly owned by the States. (Stip. 107.) Its commissioners which constitute its governing body are appointed by the

[1] This reference and those which follow are to paragraphs taken from the Stipulation of Facts entered into between the parties before the Tax Court which now appears, in I R. A., pages 36 to 89.

Governors of the respective States, by and with the consent of their senates, and they are removable only by the Governor, in the case of New York, and by the State Senate, in the case of New Jersey. (Stip. 25, 109.) Revenues, as well as all other funds, can only be expended in accordance with the specific statutes of the two States and any surplus is held subject to State direction. (Stip. 105.) All its bonds have been issued and projects undertaken pursuant to specific statutory authorization and direction. (Stip. 43, 50, 57, 72, 82, 85, 105.) Under the Comprehensive Plan, legislation of both States vested the Authority "with all the necessary and appropriate powers not inconsistent with the Constitution of the United States or of either State, to effectuate the same, excepting power to levy taxes or assessments." (Stip. 32.) The State of New York enacted legislation giving the Port Authority jurisdiction over all New York residents, corporations and property owners for the purpose of Port Authority investigations or hearings. Such legislation further provided that the Port Authority should have the power to issue orders requiring obedience by such persons, enforceable by mandamus or injunction, and to subpœna such persons with a provision for contempt in the event of failure to comply. Such investigations and hearings have been held, and such subpœnas have been issued and honored. (Stip. 115.) The Port Authority is immune from suit whether for contract or tort. This immunity has been upheld in the New York, New Jersey and Federal Courts. (Stip. 113.)

EXHIBIT 1.

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE,
Friday, March 14, 1941

Press Service
No. 24-3

The Bureau of Internal Revenue tonight began a test action intended ultimately to prove in the courts that the Federal Government has the right under the Constitution to tax the income from State and municipal securities.

Its first step was to send notices of deficiency to seven bondholders of the Port of New York Authority who had not included interest from their bonds in their tax returns filed on March 15, 1938.

The Internal Revenue Code provides that the Federal Government may not tax the interest on the securities of States, territories or "political subdivisions." It is the Treasury's contention that public corporations like the Port of New York Authority are neither states nor territories nor "political subdivisions", and that therefore the interest from their securities is not exempt from Federal income tax under the law.

If the courts agree with the Treasury on this point, they will be faced squarely with the broader constitutional question of the immunity of State and municipal securities from Federal taxation, Treasury attorneys said.

The present action represents no change in the Administration's policy of seeking to tax only the *future* issues of State and municipal securities. Secretary Morgenthau has consistently voiced opposition to proposals which would subject the interest on outstanding State and municipal securities to Federal taxes. Treasury officials feel, however, that the silence of Congress on the income tax status of obligations of the Port of New York Authority and similar public corporations has left the Department no alternative but to proceed in the present case.

To avoid putting a large class of taxpayers to unnecessary expense, the Bureau of Internal Revenue will proceed only against a few Port of New York Authority bondholders. Those to whom deficiency notices were sent tonight are Howard S. Cullman, vice-chairman of the Authority; Alexander J. Shamberg, a commissioner of the Authority; Dennistoun M. Bell, Maurice Bouvier, Henrietta J. Bouvier, Willis S. Kilmer and Martin S. Paine. It is assumed that the Port Authority will undertake the legal defense of these bondholders, especially since it defended Port Authority employes in previous tax litigation with the Federal Government.

The history of the present action goes back to the Supreme Court's decision in the Port of New York Authority salary case (Helvering v. Gerhardt, 1938, 304 U. S. 405; rehearing denied, 1938, 305 U. S. 669). The defendant in that case was an employe of the Port Authority. The court held that his salary from the Port Authority was taxable.

Shortly after this decision, Secretary Morgenthau called President Roosevelt's attention to the urgent need of legislation to remove the uncertainties created by the Supreme Court's final ruling. The Supreme Court purported to declare the law as it had always been, with the result that the Bureau of Internal Revenue had no choice but to apply the Court's decisions retroactively.

The Administration hoped that Congress would eliminate the hardships and inequalities which would flow from the retroactive application of the Port Authority case. On January 19, 1939, President Roosevelt transmitted to Congress a message recommending that Congress correct the situation. In that message, the President said:

> "Unless the Congress passes some legislation dealing with this situation prior to March 15th, I am informed by the Secretary of the Treasury that he will be obliged to collect back taxes for at least 3 years upon the employes of many State agencies and upon the security holders of many State corporate instru-

mentalities, who mistakenly but in good faith believed they were tax exempt. The assessment and collection of these taxes will doubtlessly in many cases produce great hardship.

"Accordingly, I recommend legislation to correct the existing inequitable situation, and at the same time to make private income from all Government salaries hereafter earned and from all Government securities hereafter issued subject to the general income-tax laws of the Nation and of the several States. It is difficult for almost all citizens to understand why a constitutional provision permitting taxes on 'income from whatever source derived' does not mean 'from whatever source derived.' "

Congress partially followed this recommendation by abating back taxes on public employes through the enactment of the Public Salary Tax Act of 1939, but has not yet taken any action to relieve from tax liability the holders of outstanding securities of public corporations.

If the Supreme Court now upholds the Treasury's position, the Treasury will promptly renew its recommendation to Congress (1) to abate the payment of back taxes, (2) to exempt outstanding issues from taxation, and (3) to begin the taxation of future issues.

Assuming that Congress carries out these recommendations, no holders of Port Authority and similar obligations have any reason to fear the imposition of taxes on obligations now outstanding, Treasury attorneys said.